

December 23, 2008

John Podesta
Co-Chair
President-elect Obama Transition Team
451 6th Street NW
Washington, DC 20001

The Honorable Barbara Boxer
United States Senate
112 Hart Senate Office Building
Constitution Ave & 2nd St NE
Washington, DC 20510

The Honorable Dianne Feinstein
United States Senate
331 Hart Senate Office Building
Constitution Ave & 2nd St NE
Washington, DC 20510

California Congressional Delegation
United States Congress
Washington, DC 20515

Re: Limited Federal Guaranty Program For State/Local Infrastructure Bonds

Dear Sir/Madam:

The purpose of this letter is to recommend a new and significant infrastructure financing program that will involve little, if any, costs to the federal government.

I understand that President-elect Barack Obama is expected to authorize a significant federal program that is not yet fully defined. The proposal outlined below could be implemented on an accelerated schedule and prevent the cancellation of important state and local government projects that are at risk across the nation either due to the lack of credit market access or the extremely high cost of accessing those markets.

This proposal is simple, straight forward and cost effective:

- 1) Develop a federal guarantee program of limited duration for state and local debt issued to fund new infrastructure construction and renovation. Each state could designate a state commission or agency to disburse the state's allocation of federal guarantees in accordance with the program guidelines;

- 2) Allocate these benefits, or guarantees, in the amount of \$500 to \$1,000 per capita to states. The allocations can be based on unemployment or 2000 census population, with a minimum “baseline” allocation to low-population states; and
- 3) Furthermore, the proposal would greatly benefit from abolishing the limit on the amount of deductible interest costs for commercial banks related to the purchase of these particular state and local infrastructure bonds during the term of the program. This restriction has been in place since enactment of the Tax Reform Act of 1986.

The need for this proposal stems from the recent events in the financial markets which, coupled with sagging local economies, have placed state and local governments in a very difficult situation.

Last week in California, for example, the state board responsible for advancing temporary funds for infrastructure projects was forced to shut off the flow of \$3.8 billion in loans made to fund close to 2,000 critical infrastructure projects in order to preserve cash in the State Treasury and ensure that we are able to meet all of our financial obligations. That action is expected to cost the state 200,000 private sector jobs and the loss of \$16.2 billion to our economy.

At the very time our economy needs stimulus, the markets that provide the lifeblood of public projects are frozen. Our national economy – and our local economies – cannot be restarted on broken roads. Our workers, both existing and future, will not be educated or re-trained in substandard or non-existent classrooms.

I believe this cost-effective federal program will stimulate our economy, prevent further job loss and promote confidence in our crippled banking system – a system that has been deeply wounded.

The Federal Reserve System has moved aggressively to restore confidence in our banks, but credit remains stubbornly tight. State and local government budgets are seriously challenged and spirited debate across the nation continues about the most cost-effective way to preserve jobs while cutting expenditures. We know from years of experience and compelling evidence that shutting down or postponing vital public infrastructure projects produces many negative effects. Jobs are lost. Small businesses suffer. Citizens do without necessary improvements to our roads, schools, public facilities and utilities – all envisioned and funded by them.

As demonstrated by the fact that tax-free bonds have a default rate of significantly less than 1%, issuers of municipal bonds rarely, if ever, default in the payment of their debt. That is one of the reasons there has been such robust growth in demand for municipal bonds over the past two decades. At present, however, interest rates being offered to state and local government borrowers are at unusually high levels when compared to federal securities – largely as a result of the loss of confidence in our banking system and the unavailability of credit in general.

December 23, 2008

Page 3

Since 1986, federal law has prohibited purchasers from deducting from their taxes interest earned on state and local government bonds guaranteed by the federal government. Moreover, banks are prohibited from deducting interest paid by them for funding that is necessary to buy these bonds from their local governments. In most instances, these securities are investment grade and offer rates of return that reflect the exemption of taxes on interest income.

The United States Treasury and the Federal Reserve System have infused our banks with massive sums of money to forestall financial meltdown. To date, little has been done to address the root problem: Banks are lending little as they remain risk-averse in a declining economy. By coupling a federal guarantee with these incentives to lend funds that are obtained through the federal infusion of capital to state and local governments, the United States can accomplish a great deal of stimulus with little direct cost and only minor risk of loss.

Federal guarantees cost nothing if not called upon. Local economies recover when people are put back to work and physical assets are created. Workers and businesses pay taxes on income received, offsetting any "revenue loss" arising from the exclusion of interest income. Confidence in the American banking system is restored when taxpayers see tangible evidence that so-called "bail-out" programs are aimed at essential projects that benefit them directly.

I urge you to move swiftly to consider and develop this program. Should you have any questions or concerns, I encourage you to contact me at (916) 445-2636.

Sincerely,

Original signed by:

JOHN CHIANG
California State Controller

We, the undersigned, join the Controller in urging action on this proposal.

Original signed by:

CHRIS MCKENZIE
Executive Director
League of California Cities

Original signed by:

PAUL MCINTOSH
Executive Director
California State Association of Counties

Original signed by:

BOB BALGENORTH
President
State Building & Construction Trades Council, AFL-CIO

December 23, 2008

Page 4

cc: The Honorable Arnold Schwarzenegger, Governor, State of California
The Honorable Bill Lockyer, Treasurer, State of California
Members of the California State Legislature
Mac Taylor, Legislative Analyst